No. 88-257

Supreme Court, U.S.
FILED
AUG 11 1988
JOSEPH F. SPANIOL, JR.
CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1988

IN THE MATTER OF JACOBSEN, Debtor

CASEY RZEPKA,

Petitioner,

VS.

GARY JACOBSEN,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

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THE QUESTION PRESENTED FOR REVIEW

In 1929 the U.S. Supreme Court decided a basic principle of bankruptcy law. The purpose of the new rule was to reduce fraud and corruption in the bankruptcy court system.

The Supreme Court stated that henceforth certain cases of bankruptcy fraud would *not* be decided by the bankruptcy judges as a matter of credibility. Instead, they would be decided according to a factual and objective rule that was carefully explained by the Supreme Court. (*Morimura*, 279 U.S. 24.)

That decision by the U.S. Supreme Court was never changed or overruled by any later decision.

Is the legal rule of *Morimura* still the law today in the United States?

PARTIES TO THE CASE

The parties to the case are listed in the caption of the case.

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Your petitioner, Casey Rzepka, respectfully requests that the court issue a writ of certiorari to the U.S. Court of Appeals for the Seventh Circuit, to review the decision in this case.

OPINIONS IN THE COURTS BELOW

The bankruptcy judge made an oral statement. The district federal court made a 3 page written Memorandum

and Order. The U.S. Court of Appeals for the Seventh Circuit issued a 7 page written Order. None of these were published, and all of them are included in the Appendix.

THE JURISDICTION OF THE COURT

The decision of the U.S. Court of Appeals was dated and entered on June 8, 1988. The U.S. Supreme Court has jurisdiction under 28 U.S.C. § 1254(1).

This case was first filed in the Bankruptcy Court under 28 U.S.C. §§ 151, 157. It was appealed to the District Court under 28 U.S.C. § 158(a). It was appealed to the Circuit Court of Appeals under 28 U.S.C. § 1291.

THE STATUTE INVOLVED

(11 U.S.C. § 727(a))

The federal bankruptcy code provides:

> "The court shall grant the debtor a discharge, unless * * *
>
> (4) The debtor knowingly and fraudulently, in or in connection with the case—
>
> (A) made a false oath or account * * *"

STATEMENT OF THE CASE

There is no question about the facts of this case because every significant fact was admitted by the defendant. He either admitted them in the papers he filed in court (filed under penalty of perjury; which is considered the equivalent of an oath); or he admitted them on the witness stand while testifying under oath.

The admitted facts are as follows: The defendant filed a petition in bankruptcy seeking to avoid the payment of about $1,000,000 which he owed to various workmen and other persons. The bankruptcy case was filed in the Bankruptcy Court in Chicago, Illinois under 28 U.S.C. §§ 151, 157.

The defendant was required to file certain standard papers in the Bankruptcy Court and to answer certain standard questions. The purpose of the standard questions is to make sure that the defendant's prior financial dealings could be properly understood and properly examined by the trustee in bankruptcy, and by the workmen who had money due to them, and by other interested persons.

The Concealed Bank Accounts

One of the standard bankruptcy questions—was that the defendant was required to state the name and address of every bank account that he had used at any time during the past 2 years. That information would make it possible to trace the flow of money during the past 2 years, and see where the money went. The defendant answered that question by saying (under penalty of perjury) that he had used exactly 5 different bank accounts during the past 2 years; and he gave the names and addresses of those banks.

One of the workmen who had money due to him was a man named Casey Rzepka. He did not believe the defendant's statement that there had only been 5 bank accounts. The workman engaged a C.P.A. (an auditor) to investigate the matter. The auditor found 7 more bank accounts that the defendant had operated during the 2 year period. The defendant had concealed those 7 accounts.

Many of those concealed bank accounts were large, with monthly deposits of $30,000 or $40,000. The defendant had constantly transferred money from one concealed account to another.

The defendant then filed a paper in court admitting that there had been 7 bank accounts that he had not disclosed. He admitted the large transfers of funds from one account to another. (He had to admit this since copies of his checks were put into the record.)

The defendant now stated (under penalty of perjury) that he had used a total of 12 bank accounts during the 2 year period. (The 5 bank accounts originally disclosed, plus 7 more, made a total of 12 bank accounts.)

The workman Casey Rzepka did not believe this either. He instructed the C.P.A. to continue the investigation. The C.P.A. went back to work and succeeded in finding nine (9) *more* bank accounts which the defendant had also concealed.

He continued to conceal these 9 bank accounts even *after* he knew that people were hunting for missing bank accounts. This made a total of at least 16 missing bank accounts.

The pattern of activity on the other 9 concealed bank accounts was very similar to those previously found. Some

of them were large accounts with monthly deposits of $30,000 or $40,000. There was a constant transfer of funds by the defendant from one concealed account to another.

At that point the C.P.A. stopped his investigation (which was expensive). A total of 16 concealed bank accounts had been found. There could be many more bank accounts that were not found.

The fact that the defendant omitted 16 bank accounts was mentioned by the District Court in its factual findings.

The Concealed Business

Another of the standard bankruptcy questions that the defendant was required to answer, was to give *every business name* that he had used during the past 6 years. The significance of that question is that money and assets can easily be concealed under a trade name. If the trustee in bankruptcy and the creditors do not know what trade names have been used, they would not know where to look.

The defendant answered the question (under penalty of perjury) by giving two trade names. Actually, it was discovered that he had used at least three (3) of them. One of his trade names was "Todd's Hardware Supply Co." He had concealed his ownership of that business for years. That business was *not* a corporation. When he went into bankruptcy, he simply continued to conceal it.

The Concealed Corporation

In addition to all of the above matters, the defendant also concealed the fact that he had done business through a corporation which he had created. On the witness stand, at first he denied (under oath) that there had ever been

any corporation. However, he was confronted on the witness stand with the corporation charter, the corporation records, the corporation insurance policy, and a document written in his own handwriting. He then admitted that there was a corporation which he had previously denied.

As the District Court stated in its factual findings:

> "He (the defendant) denied that there was an incorporated entity, when, in fact, there was."

The False Statements Continued For About A Year

To summarize, the defendant was guilty of making *massive* false statements, which he continued to make over a period of about one year. The false statements were made under penalty of perjury, which is considered the same as if made under oath. (1 U.S.C. § 1, 28 U.S.C. § 1746.)

The Defendant Had All His Books And Records

When the defendant filed his false papers in court he stated (under penalty of perjury) that all of his records were available to him; that he had possession of all of them; and that none of his records had ever been lost, stolen, or destroyed. (Record, page 114.)

Nine months later, when he filed more papers in court, he again stated that all his books and records were available to him and that no record had ever been lost, stolen or destroyed. (Record, page 129.)

The Question Presented

The question presented by this case was whether the defendant had been guilty of a *reckless indifference to the*

truth; and therefore was not entitled to a discharge in bankruptcy.

This question raised the special rule of law set forth by the U.S. Supreme Court in the *Morimura* case. The Supreme Court held in that case that this should *not* be handled as a question of credibility. It should be handled according to certain factual rules set forth by the Supreme Court.

The Decision Of The Bankruptcy Judge

The Bankruptcy Judge treated the case as presenting *only a question of credibility*, and ruled in favor of the defendant, and gave him a full discharge in bankruptcy.

The rule of law that was set forth by the U.S. Supreme Court in the case of *Morimura* was brought to the attention of the bankruptcy judge; but he did not follow it.

The Decision Of The District Court

The District Court treated the case as presenting only the question of whether the defendant was ". . . intentionally lying. . ." The District Court held that this was a question of *credibility* to be decided by the bankruptcy judge. Thus, the District Court felt that it was required to uphold the decision of the bankruptcy judge, and did uphold it.

The rule of law issued by the U.S. Supreme Court in the case of *Morimura* was explained to the District Judge, but he did not follow it.

The Decision Of The Court Of Appeals

The Court of Appeals took the position that the sole question was whether the defendant had ". . . knowing-

ly. . ." made false statements; and that this was a question of *credibility* to be decided by the bankruptcy judge. The essential part of the Court of Appeals decision states:

> "* * * it is apparent the bankruptcy court concluded that appellant did not knowingly and fraudulently make a false oath or account. That finding of fact was not clearly erroneous. Therefore, it must be affirmed."

The legal rule set forth by the U.S. Supreme Court in the *Morimura* case was carefully explained to the Court of Appeals, which did not follow it.

ARGUMENT

The operation of our bankruptcy court system involves millions of people, and enormous sums of money.

Ever since the bankruptcy system was started, there has been a serious problem in regard to how to handle people who file bankruptcy papers in court, which are filled with false statements: and which are designed to *conceal* the truth about the financial affairs of the debtor.

In 1929 the U.S. Supreme Court made a serious effort to solve that problem. The Court devised a *very effective* remedy which was put into effect throughout the nation.

However, 60 years have gone by and there is now a question whether the Court's decision in 1929 is still valid law today. If it is still the law today, then there *is* an effective solution to the problem of fraud and perjury in the bankruptcy courts. If the Supreme Court's decision in 1929 is no longer the law today (which is what the Seventh Circuit thinks), then our bankruptcy system is right back where it was in 1928.

At the present time there is complete confusion as to what the law is on this *basic* question of bankruptcy law. In order to reduce fraud and perjury in the bankruptcy system, the Supreme Court should say clearly whether the *Morimura* case is still valid law today; or whether it is not.

The Former Version Of The Bankruptcy Law

The bankruptcy law formerly provided that if a person made a ". . . materially false statement in writing. . ." to obtain credit, then that person would not receive any discharge in bankruptcy. The U.S. Court of Appeals throughout the United States had generally held that this meant that the false statement must have been ". . . knowingly and *intentionally* untrue. . ."

The history of this matter is set forth in an extensive article attached to the *Morimura* case. The article appears at 73 L.Ed. 587, and nearly all of the older cases are collected there. The article summarizes the older law, as follows:

> "It has been generally held that objection to a discharge under this provision will not prevail unless the statement was *knowingly and intentionally* untrue. * * *" (73 L.Ed. 588, emphasis added.)

So, the older law, as applied by the Courts of Appeal, was very similar to our present-day bankruptcy statute. Our present statute reads as follows:

> "The court shall grant the debtor discharge, unless * * * (4) the debtor *knowingly and fraudulently,* in or in connection with the case—(A) made a false oath or account; * * *" (11 U.S.C. § 727(a).)

There is not much difference between the older version of the bankruptcy law (as it was then applied); and our modern present-day version. They are quite similar.

The Old System Led To Serious Misconduct

In 1928, under the old bankruptcy statute the creditor had to prove that the defendant ". . . knowingly and intentionally. . ." made the false statement. That was considered to be a question of credibility that would be handled by the bankruptcy judge (then called the bankruptcy "referee").

If the bankruptcy judge liked the defendant (or liked his lawyer) the bankruptcy judge could just say:

> "The defendant made a tremendous number of false statements, but I believe him when he says that it was not intentional."

If the bankruptcy judge said those ". . . magic words. . ." the defendant would get a discharge in bankruptcy, regardless of all the false statements he had made.

On the other hand, if the bankruptcy judge did not like the defendant (or did not like his lawyer) the judge could just say:

> "I don't believe him."

The trouble with this system was that it gave absolute power to the bankruptcy judge. It didn't make any difference what the facts were. The only thing that was important was whether the bankruptcy judge could be persuaded to say the magic words.

Since the bankruptcy judge was deciding a question of credibility, his word would be final. The District Court would affirm the bankruptcy judge automatically (". . . it's a question of credibility. . ."); and the Court of Appeals would affirm the District Court automatically (". . . it's a question of credibility. . .").

That method of handling cases gave the bankruptcy judge too much power. It has been said many times that unlimited power is a very dangerous thing.

"Power corrupts; and absolute power will corrupt absolutely."

In 1929 the U.S. Supreme Court decided to provide a solution to this problem.

The U.S. Supreme Court Decision In The *Morimura* Case

This problem eventually reached the U.S. Supreme Court in the case of *Morimura, Ari & Co. v. Nathan Taback,* 1929, 279 U.S. 24, 49 S. Ct. 212, 73 L.Ed. 586.

The Supreme Court found a solution to the problem. It was a solution that would be based on *objective facts*; not upon a decision of credibility made by the bankruptcy judge. A defendant who had made false statements could no longer get out of it by having a bankruptcy judge say a few suitable words.

The Supreme Court held that the creditor no longer had to prove that the false statements were made intentionally. The defendant who made false statements would automatically lose his discharge if the false statements were made:

> ". . . either with actual knowledge that it was incorrect, *or,* with *reckless indifference* to the actual facts, *without examining the available source of knowledge which lay at hand, and with no reasonable ground to believe that it was in fact correct.*" (279 U.S. 33, emphasis added.)

The Supreme Court said, in effect:

1. That if the defendant had his books and records and did not bother to use them;
2. And if the defendant had no reasonable ground to believe that his false statement was correct.
3. Then the defendant has been "recklessly indifferent" to the actual facts—and he does not get a discharge in bankruptcy.

This meant that such cases could now be decided on the basis of actual *objective facts*. The defendant could no longer escape responsibility for false statements by saying: "I forgot."

Under the new rule issued by the U.S. Supreme Court, if the defendant had his books and records at the time he made his false statements, then his verbal excuses would not be accepted.

Moreover, the higher federal courts could no longer *ignore* the bankruptcy system by saying: "It's a question of credibility". Under the new rule issued by the U.S. Supreme Court *it was no longer a question of credibility*". It was now a question of facts:

1. Either the defendant had his books and records, or he did not.
2. Either the defendant had a reasonable ground for saying what he said; or he did not.

The Supreme Court in the *Morimura* case made a fundamental change in the way bankruptcy cases were to be handled.

The Rule In The *Morimura* Case Today

The basic legal principle that was set forth by the U.S. Supreme Court in the *Morimura* case is apparently followed today in the Second Circuit.

> "Successful administration of the Bankruptcy Act hangs heavily on the veracity of statements made by the bankrupt. . . Statements called for in the schedules, or made under oath in answer to questions propounded during the bankrupt's examination or otherwise, must be regarded as serious business; *reckless indifference to the truth . . . is the equivalent of fraud.* * * *"

In re Diorio, 1969, CA-2nd, 407 F.2d 1330, 1331; emphasis added.

See also: *In re Houtman*, 1978, CA-9th, 568 F.2d 651, 656 (which cites the *Morimura* case); *In re Martin*, 1985, CA-6th, 761 F.2d 1163, 1167; *In re Mazzola*, 1980, BC D. Mass. 4 B.R. 179, 183.

The Seventh Circuit Cites The *Morimura* Case With Approval But Then Refuses To Follow It

The Seventh Circuit, in its Opinion in this case, cites the *Morimura* case *with approval*; but then proceeds to apply it in such a manner as to accomplish *the exact opposite* of what the U.S. Supreme Court intended.

The Supreme Court's objective was to have such cases decided according to objective facts; and *not* as a matter of "credibility" by the bankruptcy judges. The object was to *take away* from the bankruptcy judges the absolute power that they had obtained over such cases.

The Seventh Circuit indicates in the present case that it approves of the *Morimura* decision. But, then the court says that the question of ". . . reckless indifference to the available facts. . ." is just a question of *credibility*; which should be decided by the bankruptcy judge(!)

Thus, the decision in the *Morimura* case is turned *upside down* and rendered meaningless. The law in the Seventh Circuit is thus returned exactly to what it was in 1928.

The Opinion Of The Seventh Circuit

The Opinion issued by the Court of Appeals for the Seventh Circuit (Chicago) is filled with serious factual and legal errors.

There were 16 missing bank accounts as admitted in the trial court. This is *correctly* stated in the Opinion of the District Court. However, in the Court of Appeals Opin-

ion, the 16 missing bank accounts are changed to 9 missing bank accounts, for some unknown reason. (Of course, even 9 missing bank accounts is a fantastic "error".)

It was admitted in the trial court that the defendant had a corporation, which he had concealed. That was *correctly* found as a fact in the Opinion issued by the District Court. For some unknown reason, the fact disappears in the Opinion issued by the Court of Appeals.

The defendant in this case stated *twice* in writing (under penalty of perjury) that he had all of his books and records at the time he prepared his bankruptcy schedules. (Record, pages 114, 129.) Under the rule set forth in the *Morimura* case, that is a very important fact. The Court of Appeals Opinion leaves out that fact entirely.

The Court of Appeals decision contains numerous other serious errors.

Why Bank Accounts Are Concealed

When a person wants to conceal money, he often puts it into bank account "A". Then, he later transfers that money to a different bank, and puts it into bank account "B". He keeps on making transfers from one bank to another, through a series of perhaps 20 or 30 bank accounts. The last bank account in the line will be in Hong Kong or in some other remote place.

When the defendant files his schedules in bankruptcy, he reports only bank accounts A and B. He leaves out all the other bank accounts in the chain. A chain of bank accounts of that kind is sometimes called "the pipeline". He leaves out the chain of bank accounts on the bankruptcy schedules; and so it becomes impossible to trace the money and find out where it went.

It may be noted that the defendant in *this* case was found to be constantly engaged in transferring funds from one concealed account to another.

Truthful Information Is Essential To The Proper Operation Of The Bankruptcy System

The courts have held many times that truthful information is absolutely essential to the operation of the bankruptcy court system. (*In re Chalik*, 1984, 748 F.2d 616; *In re Mascolo*, 1974, CA-1st, 505 F.2d 274, 278.)

That was, of course, one of the reasons why the Supreme Court decided the *Morimura* case—to help insure that truthful information would be filed in court; and that defendants would not be allowed to hide behind *a wall* of falsehoods and deceptions.

The Legal Rule Of *Morimura* Applies To This Case

The legal rule set forth by the U.S. Supreme Court in *Morimura* applies directly to our present case:

(1) The defendant in this case had all his books and records.

(2) He put massive false statements into his bankruptcy papers.

The rule of *Morimura* applies automatically to such situations; and the defendant is not entitled to a discharge in bankruptcy.

CONCLUSION

The Supreme Court should grant the writ of certiorari and decide whether the *Morimura* case is still valid law in the United States today. It would certainly appear to be valid, since it was never changed or overruled by the Supreme Court at any later time.

If this rule of law is still valid today, this will have a very helpful effect upon our bankruptcy court system. It will go a long way towards reducing fraud, perjury and misconduct.

If the *Morimura* case is not the law today, then the court should say so. In that event, the bankruptcy court system will be back where it was in 1928. The improper activities that took place in 1928 are likely to be repeated.

The Supreme Court should seriously consider taking this case, for two reasons:

1. The bankruptcy court system involves millions of people.
2. The honesty and integrity of the bankruptcy system are very much involved here.

Respectfully submitted,

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